INTERNATIONAL DAIRY FOODS ASSOCIATION TESTIMONY IN OPPOSITION TO CALIFORNIA DAIRY CAMPAIGN PROPOSAL 6, WHICH WOULD INCLUDE MOZZARELLA CHEESE IN THE PRODUCT PRICE SURVEYS USED TO ESTABLISH MINIMUM CLASS III PRICES

This testimony is submitted on behalf of the International Dairy Foods Association (IDFA) with respect to Proposals 6. This Proposal would add mozzarella cheese to the product surveys used to establish minimum Class III prices.

USDA has consistently rejected including cheeses other than cheddar, and specifically mozzarella, in the price surveys used to establish the protein value that is included in setting minimum Class III prices.

When USDA in 1999 used notice and comment rulemaking to carry out Congress' mandate to consolidate the existing federal orders and consider other order reforms, it noted that several "commenters argued that all varieties of cheese should be included in the NASS price survey to assure that all cheese value is captured." Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders, 64 Fed. Reg. 16026, 16098 (Apr. 2, 1999). However, USDA concluded that it was unworkable to have a system that tried to contour minimum milk prices to reflect the unique compositions of each Class III product. USDA instead adopted a system that calculated a minimum price based on cheddar, which would "enable handlers to adjust prices paid to producers to account for additional value above the minimum Federal order prices." Id. at 16099.

In so doing, USDA emphasized that the minimum milk price being established for each commodity (cheese, butter and nonfat dry milk) needed to be the market clearing price for that commodity:

> This pricing plan [being adopted by USDA] will allow the market-clearing price level of each of these manufactured products to be achieved independent of the other products. As a result, dairy farmers will be paid a price which is more representative of the level at which the market values their milk in its different uses. **The importance of using minimum prices that are market-clearing for milk used to make cheese and butter/nonfat dry milk cannot be overstated. The prices for milk used in these products must reflect supply and demand and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit.** Id. at 16095.

As USDA further explained when it later considered additional milk order amendments in 2000, the problems with included other types of cheeses in setting minimum prices are that: (a) the resulting product price would not be representative of the value of any particular product, and (b) the make allowance deducted from that product price in order to establish minimum Class III milk prices would not be reflective of the cost of processing that cheese, because the make allowance data relied upon to set minimum milk prices relates solely to cheddar cheese. As USDA explicated in rejecting such an approach:

> Several witnesses testified that types of cheeses other than cheddar should be included in the NASS price survey as a more comprehensive basis for identifying a cheese price, although such a proposal was not included in the hearing notice. The cheddar cheese included in the NASS survey meets certain standard criteria that makes prices for the reported cheese sales comparable. If the survey included other descriptions of cheddar and other types of cheese, such as mozzarella, it would not be possible to consider the reported price as representative of the value of any particular product. Further, the manufacturing costs surveyed are, to a great extent, limited to the costs of processing cheddar cheese.

Milk in the Northeast and Other Marketing Areas; Tentative Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and to Orders, 65 FR 76832, 76846 (Dec. 7, 2000).

All these USDA conclusions remain valid today, with respect to both the criteria for inclusion in the price survey, and the existence of costs of manufacture.

Criteria for inclusion. USDA has established very specific criteria for cheese to be included in the average price survey used to set minimum milk prices. For Class III, the survey covers (i) the National Dairy Products Sales Report (NDPSR) of prices paid for 40-lb. block cheddar cheese; and (ii) the NDPSR for prices paid for 500-pound barrel cheddar cheese (38 percent moisture). 7 C.F.R. 1000.50(n). To be included in these Sales Reports, cheddar cheese must meet various criteria, including age (no less than 4 days or more than 30 days on the date of sale); color (within a specified color range for 40-pound blocks; white for 500-pound barrels); and moisture content (no more than 37.7% moisture for 500-pound barrels). 7 C.F.R. 1170.8(a).

No similar USDA Sales Report criteria exist for mozzarella cheese. Furthermore, the commercial mozzarella cheese market contains very wide variability in the relevant criteria. For example, FDA standard of identity regulations provide for four different variants of mozzarella cheese, with widely varying fat and moisture parameters, see 21 C.F.R. 133.155 (mozzarella, minimum 45% fat and 52 to 60% moisture); 21 C.F.R. 133.156 (low-moisture mozzarella, minimum 45% fat and 45 to 52% moisture); 21 C.F.R. 133.157 (part-skim mozzarella, 30 to 45% fat and 52 to 60% moisture); and 21 C.F.R. 133.158 (low-moisture part-skim mozzarella, 30 to 45% fat and 45 to 52% moisture).

In short, it would be likely be impossible to select a suite of criteria for inclusion of mozzarella in a pricing survey that would adequately represent the market value of mozzarella cheese as a whole.

Method and cost of manufacture. Even if pricing information for mozzarella were obtainable, no reported survey data includes the cost of making mozzarella cheese. No party to this hearing has purported to provide such survey data for the record. Thus, even if one were somehow develop a reportable price of mozzarella cheese, one would still have to use as the make allowance the cost of making cheddar cheese. But given that the minimum prices for Class III milk is the selling price of the finished product minus the cost to make the product, basing the finished product price on the price of both cheddar cheese and mozzarella, while basing the make allowance solely on the cost of making cheddar cheese, would be a complete mismatch.

This is especially true because the two cheeses are quite different in content and method of production. Cheddar must contain no less than 50% milkfat by weight of the solids and a maximum 39% moisture with no minimum, according to FDA Regulation 21 C.F.R. Section 133.113(a). By contrast, the minimum milkfat content of mozzarella cheese is 45 percent by weight of the solids, and the moisture content is more than 52 percent but not more than 60 percent by weight. 21 C.F.R. 133.155(a)(1).

These differences in content necessarily make the products heterogeneous and lacking the similarities sufficient to include both in the same pricing formula. These differences are result in material differences in the costs of manufacture, which foreclose as a practical matter deriving a uniform cost of manufacture that could be utilized in a product pricing formula.

That heterogeneity is exacerbated by the divergence between the manufacturing steps used in cheddar versus mozzarella production. Cheddar cheese is subject to specific mandatory manufacturing steps:

> [Cow's milk or another specified dairy ingredient] may be warmed, treated with hydrogen peroxide/catalase, and is subjected to the action of a lactic acid-producing bacterial culture. One or more of [specified] clotting enzymes specified is added to set the dairy ingredients to a semisolid mass. The mass is so cut, stirred, and heated with continued stirring, as, to promote and regulate the separation of whey and curd. The whey is drained off, and the curd is matted into a cohesive mass. The mass is cut into slabs, which are so piled and handled as to promote the drainage of whey and the development of acidity. The slabs are then cut into pieces, which may be rinsed by sprinkling or pouring water over them, with free and continuous drainage; but the duration of such rinsing is so limited that only the whey on the surface of such pieces is removed. The curd is salted, stirred, further drained, and pressed into forms. One or more of the other [specified] optional ingredients may be added during the procedure.

21 C.F.R. 133.113(a)(3).

Mozzarella cheese is subject to different specific required manufacturing steps:

> [Cow's milk or another specified dairy ingredient] is warmed to approximately 88 °F and subjected to the action of a lactic acid-producing bacterial culture. One or more of [specified] clotting enzymes is added to set the dairy ingredients to a semisolid mass. The mass is cut, and it may be stirred to facilitate separation of whey from the curd. The whey is drained, and the curd may be washed with cold water and the water drained off. The curd may be collected in bundles for further drainage and for ripening. The curd may be iced, it may be held under refrigeration, and it may be permitted to warm to room temperature and ripen further. The curd may be cut. It is immersed in hot water or heated with steam and is kneaded and stretched until smooth and free of lumps. It is then cut and molded. The molded curd is firmed by immersion in cold water and drained. One or more [other specified] optional ingredients may be added during the procedure.

21 C.F.R. 133.155(a)(3). These differences in content and processing (e.g, the washing, kneading, stretching and molding for mozzarella but not cheddar) are necessarily reflected in the use of different and additional equipment.

Accordingly, the cost of making cheddar is quite different than the cost of making mozzarella. One could not reliably use the former as a proxy for the cost of the latter for purposes of setting minimum milk prices. Yet the cost data for doing something else does not currently exist within USDA or this hearing record, and even if it did, calculating and applying different make allowances within the same product category would unduly complicate the effort to set minimum milk prices, especially given the differences in the various categories of mozzarella.

Mozzarella lacks market-clearing capacity.

Mozzarella is made further unsuitable because it cannot establish an effective market-clearing price. As noted, USDA has itself emphasized that "the importance of using minimum prices that are market-clearing for milk used to make cheese and butter/nonfat dry milk cannot be overstated," and that "prices for milk used in these products must reflect supply and demand, and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit."

It is cheddar, not mozzarella, which can serve this market clearing function for cheese.

- Cheddar is the true commodity cheese product, usable both in its own form and as a component of processed cheeses. Mozzarella is not.
- Cheddar is routinely traded in bulk form (40-pound blocks or 500-pound barrels) that meet the National Dairy Products Sales Report requirements. Bulk cheddar is routinely sold to other companies that either shred or cut them or perform further processing to create additional cheese products. Mozzarella by contrast is often made and sold to the specific specifications

of specific customers. I am informed that a single mozzarella company may have hundreds of different product codes for its mozzarella products.

- Both cheddar variants (40-pound blocks or 500-pound barrels) are traded on the CME, and thus subject to easy price-discovery and straightforward hedging. Mozzarella is not so traded or directly hedgeable.
- Last but certainly not least, cheddar is the cheese more often produced to clear the market of surplus milk, given that cheddar is readily storable for extended periods, and the processor can make bulk cheddar products using surplus milk with reasonable confidence that it will be able to find a buyer while the cheese is still saleable. That confidence is bolstered by the fact that standard cheddar cheese can be sold to a variety of companies that will use bulk cheese making a variety of food products. By contrast, most mozzarella is stored in refrigerated form and by comparison has a limited shelf life, and once produced encounters fewer potential outlets.

Other issues.

Proponents have argued that a recent USDA food procurement solicitation resulted in mozzarella being delivered at an average price per pound of $3.6445, as compared to an AMS survey price for cheddar of less than $1.50 per pound. Proponents infer that they are missing out when minimum milk prices are based on cheddar rather than mozzarella. This is not a proper conclusion to reach.

Some of that price difference reflects cost differences based upon differences in the equipment used and methods employed to make mozzarella versus cheddar, as I have already discussed. Furthermore, the USDA solicitation to which Proponents refer

entailed the purchase of one-ounce mozzarella string sticks, 360 to the box, to more than a dozen cities throughout the United States. (A copy of the solicitation appears as Hearing Exhibit 95.) Thus, as compared to the AMS reported price for cheddar cheese, which is an FOB plant price for bulk cheese in either 40-pound blocks or 500-pound barrels, the USDA solicitation was for mozzarella cheese that: (a) had been shaped into strings, which is itself an equipment specific and laborious undertaking; (b) cut into one-ounce pieces; (c) packaged and labeled individually; (d) packed 360 to a box, and (e) delivered by the seller in hundreds of boxes quantities to 36 different locations ranging from Alabama to California, and from Minnesota to Texas. The sales price information is not comparable.

For all these reasons, mozzarella cheese should not be included in the product price surveys used to establish minimum Class III prices.